



# Defining and Tackling Tax Avoidance

**What is tax avoidance?** Avoidance is notoriously difficult to define; but decades of case law indicate that there are two key elements to it: a purpose of the law element, whereby the arrangement put in place goes against the intention of the legislator; and an artificiality element, whereby the main or sole purpose of the arrangement is to obtain a tax advantage. The exact definition, however, is not only contested, but has changed over time.

**How to tackle tax avoidance?** Tax avoidance has traditionally been tackled through anti-avoidance measures: specific or general; legislative (statutory) or jurisprudential. Whilst necessary, these measures often undermine legal certainty and legitimate expectations, and thus should be applied with caution. Changes to the legal design of corporate income tax and VAT would tackle the causes of avoidance, rather than deal with its symptoms, and represent a more effective, and legally fairer, way of combatting avoidance.

## Key points:

A comprehensive analysis of the case law of the Court of Justice of the European Union on abuse and abusive practices for the last 40 years, and in particular its recent tax decisions, highlights **the creation of a new EU general principle of prohibition of abuse of law.**

**Anti-avoidance measures can undermine fundamentals of our legal system**, such as legitimate expectations and legal certainty - even the rule of law - and therefore they should be used carefully and constructed as **last resort measures.**

While completely eliminating tax avoidance is virtually impossible, **careful legal design and drafting would substantially reduce scope of, and incentives for, avoidance.**



“ Anti-avoidance measures have a last-resort purpose, but if we want to fix the underlying sources of [tax avoidance], we need to re-examine the fundamentals of our system.

*Professor Rita de la Feria*

‘No matter how well drafted they are, anti-avoidance measures will eventually be out of date. Which means that tax authorities will always be playing catch-up.’

Professor Rita de la Feria

## The State of Play

### The EU Principle of Prohibition of Abuse of Law...

Since the CJEU VAT decision in *Halifax*, the prohibition of abuse of law has firmly established itself as an EU – general or interpretative – principle. Under *Halifax*, an abusive practice will be found to exist where two conditions are met: the arrangement put in place goes against the intention of the legislator; and the main or sole purpose of the arrangement is to obtain a tax advantage.

Unfortunately – but unsurprisingly – the application of the concept has been far from uniform: not only have different courts taken different

approaches to it, particularly as regards the criteria for determining the existence of abuse, but there have been different approaches depending on the subject area. In particular, there has been a marked difference between what constitutes abuse for the purposes of VAT, and what constitutes abuse for the purposes of direct taxation. After the decision in *Cadbury Schweppes*, it appeared as if the Court would attempt to harmonise the concept of abuse of law by applying that used within VAT, namely in *Halifax*, to direct taxation. Instead, the recent decision in *Ocean Finance* appears to indicate the contrary.

### ... And the risks of over-reliance on anti-abuse principles

Recent case law developments have highlighted both the difficulties of applying the concept of abuse of law, and the risks of relying too heavily on it. *Ocean Finance* appears to indicate a subtle move towards equating abuse of law with artificiality. This is a dangerous development. Can an arrangement, which is not against the purpose of the law, and thus within the intention of the legislator, be deemed abusive solely on the basis that it was undertaken with sole purpose of saving tax? How can an arrangement that complies with both the word and purpose of the law be deemed unacceptable?

### Ways forward:

- **Corporate income tax:** substitution of the source and residence principles with the destination principle, and adoption of a destination-based corporate tax.
- **VAT:** elimination of exemptions (merit and technical), and rationalisation of the use of reduced rates.

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This research has been cited by the Court of Justice of the European Union, in the Latvian Administrative District Court, the Swedish Supreme Administrative Court, the High Court of Ireland.

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